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SIPDIS

DEPARTMENT FOR EUR/CE JMOORE, EB/OMA, INR/EC;; TREASURY FOR
ERIC MEYER, JEFF BAKER, LARRY NORTON; COMMERCE FOR SSAVICH

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SUBJECT: NEW ECONOMIC REALITY FOR HUNGARY'S NORTHWEST

Classified By: ECONOMIC OFFICER STEVE WESTON FOR REASONS 1.4(b) and (d)

11. (C) Summary. Eighteen months ago, Hungary's north and northwest regions enjoyed the lowest unemployment rates and among the highest average incomes in the country. Host to a number of large export-oriented international automotive and technology companies and their suppliers, today the region is coping with the lingering effects of recession, volatile exchange rates, a lack of credit hurting small and medium-sized enterprises, and the unanticipated effects of neighboring Slovakia's entry into the eurozone. The recession has also strained relations between major manufacturers forced to downsize and host towns hoping to preserve jobs. Echoing a country-wide trend, the impact of the economic crisis is heightening levels of dissatisfaction with the political status quo, and support for the opposition Fidesz Party is strong. Expectations are high that the next government will be more responsive to the needs of smaller domestic businesses, and will enhance Hungary's competitiveness in the region to attract foreign investment. End Summary.

HUNGARY'S NORTH AND NORTHWEST BORDER REGION

12. (U) Hungary's northwest border region has been one of the primary sources of Hungary's export-led growth in recent years, and the region has enjoyed the lowest unemployment rates and some of the highest income levels in the country. Multinational manufacturers and their suppliers make up an important segment of the economies of medium-sized northern towns such as Győr, Esztergom, Komárom, and Tatabánya. Audi, Suzuki, GE, and Nokia are among the region's largest employers, and their competitive, export-oriented production facilities that support scores of local suppliers have contributed significantly to the region's low employment rate, and to Hungary's export-led growth. The region also has a vibrant agricultural sector, and is host to Hungary's largest milling company.

ECONOMIC CRISIS HITS THE NORTHWEST

13. (C) The recession in Germany and other key European markets weakened demand for Hungarian exports, and the government's fiscal consolidation program and austerity measures have suppressed domestic demand. As a result, Hungary is projecting a recession of 6.7 percent for 2009, and unemployment in October reached 10.5 percent, the highest rate since 1996. As orders dry up, manufacturers are forced to reduce output and lay off workers. Managing Director of Suzuki Hungary Hisashi Takeuchi notes that Suzuki's production in Hungary is down by over one-third, and about 15 percent of its Hungarian suppliers are facing bankruptcy or ownership changes this year. Karoly Kovacs, Managing Director of the Komárom Industrial Park, home to a large Nokia plant and a number of Nokia suppliers, notes that a number of small Nokia suppliers are winding up their

businesses because they cannot survive on the greatly reduced number of orders. Weak domestic demand has caused new auto registrations to plummet 70 percent year on year, according to October statistics. As a result, Suzuki closed a third of its auto dealerships, from a previous high of 150 in 2008 to just over 100 today.

¶4. (U) Because of the region's previously low rate of unemployment, northwest Hungary faces the largest increase in unemployment in the country. In addition to manufacturing, Joseph Juhasz, President of the Komarom-Esztergom County Chamber of Commerce notes that the construction industry in the region has been particularly hard hit.

SLOVAK CONTRACT WORKERS OFTEN THE FIRST TO GO

¶5. (C) Manufacturers near the border with Slovakia have long relied on thousands of temporary or contract workers from predominantly Hungarian-speaking southern Slovakia. Unlike "permanent" employees, these contract workers can be terminated easily and at a lower cost to employers. When orders began falling this year, these workers were often the first to be let go. A lawyer with knowledge of the Komarom industrial park estimated that some 70 percent of the nearly 5,000 Slovak workers hired through intermediary employment agencies lost their jobs at Nokia or Nokia suppliers in northern Hungary.

IMPACT OF CURRENCY VOLATILITY, SLOVAKIA'S EUROZONE MEMBERSHIP

¶6. (U) The volatile Hungarian currency, coupled with Slovakia's eurozone membership in January 2009 has also had a

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significant impact on the region. As the Hungarian forint weakened substantially against the euro early this year, Hungarian retailers experienced a significant increase in Slovak citizens crossing the border to shop in Hungary.

¶7. (C) Northern Hungary's "mini-retail boom" has not been beneficial for Hungarian agricultural producers, however. Hungarian farmers complain that farmers in southern Slovakia, unable to sell their goods domestically when much cheaper products are available to Slovak consumers willing to travel into Hungary, began dumping dairy and other agricultural products in the Hungarian market at prices below market value. Hungarian farmers note that during this period, Slovakian farmers were willing to sell at a considerable loss in Hungary because otherwise their goods would go unsold. Hungarian farmers also accuse large retailers like Auchan and Tesco of taking advantage of this opportunity to cut them out by purchasing directly from farmers in Slovakia.

¶8. (U) Larger manufacturers who export most of their products to the eurozone have not felt a considerable impact from exchange rate volatility. Suzuki officials, for example, note that 90 percent of the company's sales and purchases are euro-based, so they are largely insulated from exchange rate shocks.

LACK OF CREDIT HURTS SMALL BUSINESSES

¶9. (U) Hungarian Chamber of Commerce officials note that the lack of credit available to small businesses remains a problem throughout the country, and northern Hungary is no exception, as banks reduce credit extended to small businesses because of their greater perceived levels of risk.

Chamber of Commerce officials note that a key program that has allowed many small businesses to survive the recession is the "Szechenyi Card". Launched by the former Fidesz government and expanded under the Socialists, the program provides small businesses with a government guaranteed line of credit of up to 100,000 euros. Over 85,000 Szechenyi Cards are in use today.

RELATIONS WITH LOCAL GOVERNMENTS

¶10. (C) The economic situation has strained relations between major manufacturers forced to downsize and host towns hoping to preserve jobs. Some local officials complain that large companies are not doing enough to preserve jobs, and that foreign-based headquarters make decisions on production line and plant closures without considering the impact on the local economy. They further complain that large manufacturers increasingly abandon local suppliers in favor of cheaper overseas suppliers - often from China. Komarom Industrial Park Director Kovacs admitted his town made a mistake to "rest the entire industrial park on a single pillar - Nokia," and said that the local government is trying to market the park to other industries as well. On the other hand, companies like Suzuki note that although local and national governments actively support new potential investors, they do relatively little to support existing investment.

THE NORTHWEST MOVES RIGHT

¶11. (C) Meetings with businesses, farmers and other citizens in northwest Hungary echo trends we are seeing throughout the country - that the governing Socialist Party is seen as the primary cause of the nation's economic woes, and as a result, the electorate is moving increasingly to the right. Officials note that there has been an increase in rallies this year in Esztergom and other northern towns by far-right groups like Jobbik. Although the far right seems to be making the greatest gains among those most negatively impacted by the current economic situation, the business community appears to favor the center-right Fidesz Party, which it sees as a champion of Hungarian small business interests, and which they hope will help improve Hungary's international competitiveness.

CROSS-BORDER COOPERATION

¶12. (C) A common theme in meetings with economic actors in the region is the good relations between the predominantly Hungarian speaking communities on both sides of the border. Joint cultural, educational and business events occur regularly. For example, there are a number of student exchange programs, and the Esztergom-Komarom County Chamber of Commerce noted that they are working on a joint EU tender with their counterparts in Slovakia. Many in the region view

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recent tensions between the two capitals as merely an attempt by political interests on both sides to divert attention away from domestic political issues.

COMMENT: THE END OF THE COMPANY TOWN AND HIGH EXPECTATIONS FOR FIDESZ

¶13. (C) Many small businesses and suppliers to major manufacturers are trying to hold on until export markets in Western Europe rebound and orders pick up again. In the longer term, cities and towns plan to increase efforts to attract a more diverse group of companies so their economic health is not linked to the success of a single industry. With the Socialist Party receiving most of the blame for the current economic situation, northern Hungary is expected to join much of the rest of the country in supporting Fidesz in national elections next year. Expectations for the new government will be high, however, particularly among smaller businesses, who will be looking to Fidesz to match their rhetoric with results.

14 (U) This message has been cleared by Embassy Bratislava.
LEVINE